

IRS News Release

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IRS Targets Down-Payment-Assistance Scams; Seller-Funded Programs Do Not Qualify As Tax Exempt

WASHINGTON, DC – Organizations that provide seller-funded down-payment assistance to home buyers do not qualify as tax-exempt charities, the Internal Revenue Service said in a ruling released today.

Down-payment-assistance programs provide cash assistance to homebuyers who cannot afford to make the minimum down payment or pay the closing costs involved in obtaining a mortgage. Such programs can qualify as tax-exempt charitable and educational organizations under Internal Revenue Code section 501(c)(3) when properly structured and operated. In Revenue Ruling 2006-27, released today, the IRS provides a detailed discussion of the guidelines – including two examples that meet – and one that fails to meet – the tests for exemption.

The ruling makes it clear that seller-funded programs are not charities because they do not meet the requirements of section 501(c)(3). Increasingly, the IRS has found that organizations claiming to be charities are being used to funnel down-payment assistance from sellers to buyers through self-serving, circular-financing arrangements. In a typical scheme, there is a direct correlation between the amount of the down-payment assistance provided to the buyer and the payment received from the seller. Moreover, the seller pays the organization only if the sale closes, and the organization usually charges an additional fee for its services.

A March 2005 report entitled, “An Examination of Downpayment Gift Programs Administered By Non-Profit Organizations,” commissioned by the U.S. Department of Housing and Urban Development (HUD), found that seller-funded down-payment assistance has led to underwriting problems and resulted in an increase in the effective cost of homeownership. A report from November 2005 entitled, “Mortgage Financing: Additional Action Needed to Manage Risks of FHA-Insured Loans with Down Payment Assistance,” conducted by the U.S. Government Accounting Office (GAO) found similar results.

“The IRS is increasingly concerned with organizations that are taking advantage of homebuyers who need assistance for a down payment to realize the American dream of homeownership,” said IRS Commissioner Mark W. Everson. “So-called charities that manipulate the system do more than mislead honest homebuyers and ultimately jack up the cost of the home. They also damage the image of honest, legitimate charities.”

The IRS is examining 185 organizations that operate down-payment-assistance programs. A particular organization's tax-exempt status can be verified using the on-line database at irs.gov (click on "Charities & Non-Profits" and then click on "Search for Charities"). In addition, the agency has denied applications for tax exemption from over 20 organizations that seek to provide this service and is considering applications from a number of other down-payment assistance organizations.

Revenue Ruling 2006-27 will be published in Internal Revenue Bulletin 2006-21, dated May 22, 2006.